

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 BUENOS AIRES 8078

E.O. 11652: GDS
TAGS: EGEN, ELAB, EFIN, EINV, AR
SUBJECT: ECONOMIC SITUATION IN ARGENTINA

SUMMARY. OVER LUNCH ON DECEMBER 8, WALTER KLEIN, SECRETARY FOR PLANNING AND COORDINATION IN THE MINISTRY OF ECONOMY, BRIEFED DEPUTY ASSISTANT SECRETARY BRAY ON ARGENTINA'S ECONOMIC SITUATION. KLEIN INFORMED BRAY THAT: THE DELAY IN ISSUING THE IMPLEMENTING REGULATIONS TO THE FOREIGN INVESTMENT LAW WAS PRIMARILY DUE TO A DESIRE TO AVOID REPEATING PAST MISTAKES; HE WOULD RECOMMEND MAJOR WAGE INCREASES FOR ALL WORKERS IN JANUARY BUT A HIGHER AMOUNT FOR CIVIL SERVANTS; HE WAS CONFIDENT THE BUDGET DEFICIT WOULD BE REDUCED SUBSTANTIALLY IN 1977 THROUGH INCREASED TAXES; THE TOP MILITARY LEADERS WERE PERSUADED OF THE NEED FOR AND WOULD ACCEPT EVEN A MEDIOCRE POLICY RATHER THAN CHANGE DIRECTIONS; POLITICAL PRESSURES FROM THE INDUSTRIAL SECTOR WOULD INCREASE BUT THE GOA HOPED TO CONTROL THEM BY REMOVING PROTECTIONIST MEASURES GRADUALLY ; GDP WILL DECLINE ABOUT 3 PERCENT IN 1976 AND RISE 5 PERCENT IN 1977; AND INFLATION WILL BE CONTAINED BELOW THE 100-110 PERCENT PROJECTED BY PRIVATE SOURCES. END SUMMARY.

2. KLEIN EXPLAINED THAT THE DELAY IN ISSUING THE IMPLEMENTING REGULATIONS TO THE FOREIGN INVESTMENT LAW WAS PRIMARILY DUE TO A DESIRE TO AVOID REPEATING THE MISTAKES MADE IN THE PAST. AS A RESULT, THE REGULATIONS ARE PARTICULARLY LONG, COMPLEX AND ARE CURRENTLY BEING REVIEWED BY THE PRESIDENT. BEFORE BEING PUBLISHED, THE LEGISLATIVE ADVISORY COUNCIL (CAL) WILL BE GIVEN THE OPPORTUNITY TO STUDY AND COMMENT ON THE REGULATIONS BUT DOES NOT HAVE
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THE POWER TO BLOCK THEM. KLEIN WAS CONFIDENT THAT THEY WOULD

BE ISSUED BEFORE THE END OF THE YEAR.

3. LABOR AND WAGES

MR. BRAY ASKED KLEIN HOW HE COULD EXPLAIN THE PATIENCE OF ARGENTINE LABOR IN RECENT MONTHS. KLEIN REPLIED THAT, WHILE THERE WAS NO QUESTION THAT REAL WAGES HAD DECLINED, THE EXTENT OF THE DECLINE WAS STATISTICALLY OVERSTATED: (1) REAL WAGES WERE LOWER THAN INDICATED DURING THE PERIOD OF PRICE CONTROLS (PRESUMABLY BECAUSE OF FAILURE TO ADHERE TO OFFICIAL PRICES); AND(2) WERE NOW HIGHER THAN SHOWN IN THE STATISTICS BECAUSE OF UNOFFICIAL INCREASES. MOREOVER, BY KEEPING WAGES LOW, THE GOVERNMENT HAD AVOIDED ANY SERIOUS INCREASE IN UNEMPLOYMENT.

4.DESPITE ALL THE RECENT CONFUSION ABOUT THE SELECTIVE WAGE INCREASES IN NOVEMBER, KLEIN SAID THEY REPRESENTED AN INCREASE OF ROUGHLY 15 PERCENT IN THE PRIVATE SECTOR. IN JANUARY, THE GOA WILL GRANT GENERAL WAGE INCREASES BUT THE EXACT AMOUNT STILL HAS NOT BEEN DETERMINED. KLEIN SAID HE PERSONALLY WOULD RECOMMEND A GENERAL 25 PERCENT INCREASE FOR THE PRIVATE SECTOR, WITH A GREATER DEGREE OF FLEXIBILITY TO GIVE ADDITIONAL INCREASES IF PRICES ARE NOT RAISED OR ADDED LABOR COSTS ARE NOT DEDUCTED FROM INCOME FOR TAX PURPOSES. AS FOR THE GOVERNMENT SECTOR, WHICH DID NOT RECEIVE ANY WAGE INCREASE IN NOVEMBER, KLEIN WOULD PROPOSE INCREASES OF 41 PERCENT FOR THE LOWER-RANKING CIVIL SERVANTS AND 100 PERCENT FOR THE EXECUTIVE LEVEL.

5. IN 1977, THE GOA ALSO HOPES TO REDUCE THE NUMBER OF GOVERNMENT EMPLOYEES BY 50,000. PART OF THE PROBLEM IN ELIMINATING EXCESS EMPLOYEES, HE EXPLAINED, IS THAT THE CURRENT LAW PERMITTING DISMISSAL FOR REDUNDANCY IS THE SAME AS THAT FOR SUBVERSION --SO THAT DISMISSED CAN DAMAGE THE REPUTATION OF AN INDIVIDUAL. TO CORRECT THIS LEGAL DIFFICULTY, KLEIN WILL PROPOSE A NEW REGULATION WHICH WOULD PERMIT DEPARTMENTS TO PUT EMPLOYEES ON AN "AVAILABLE" LIST AND, IF NO OTHER GOVERNMENT DEPARTMENT EMPLOYS THEM WITHIN A CERTAIN PERIOD OF TIME, THEY WOULD BE DISMISSED.

6. BUDGET

WHEN ASKED ABOUT THE BUDGETARY IMPACT OF THE PROPOSED WAGE
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INCREASES, KLEIN SAID THAT THE PROBLEM WAS NOT INSURMOUNTABLE, PARTICULARLY SINCE PERSONNEL EXPENDITURES ARE A RELATIVELY SMALL PERCENTAGE OF TOTAL EXPENDITURES. IN THE STATE ENTERPRISES, REVENUE HAD INCREASED SUBSTANTIALLY AS A RESULT OF CATCH UP RAISES IN THE RATES OF SERVICES. IN THE PROVINCES, GREATER USE WILL BE MADE OF THE REAL ESTATE TAX, THUS REDUCING THE NEED FOR SUBSIDIES FROM THE NATIONAL ADMINISTRATION. AT THE NATIONAL LEVEL, THE GOA WOULD TAKE MEASURES TO: (A) REDUCE CORRUPTION IN THE

TAX DEPARTMENT BY IMPROVING AUDIT PROCEDURES; (B) IMPROVE TAX COLLECTION BY REDUCING TAX EVASION AND SIMPLIFYING THE TAX SYSTEM; AND (C) IF KLEIN'S RECOMMENDATION IS ACCEPTED, INSTITUTE A NATIONAL ASSETS TAX PAYABLE BY ALL INDIVIDUALS WITH A CERTAIN MINIMUM LEVEL OF GROSS ASSETS. THE PROVINCIAL REAL ESTATE TAX COULD BE CREDITED AGAINST THE ASSETS TAX AND THE ASSETS TAX COULD IN TURN BE CREDITED AGAINST THE INCOME TAX.

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C O N F I D E N T I A L SECTION 2 OF 2 BUENOS AIRES 8078

7. UNITY OF THE MILITARY JUNTA

MR. BRAY SAID HE HAD HEARD CONSIDERABLE DISCUSSION ABOUT DIFFERENCES IN THE MILITARY LEADERSHIP AND WONDERED WHETHER THESE DIFFERENCES WERE CREATING PROBLEMS IN THE ECONOMIC SPHERE. MR. KLEIN REPLIED THAT, WHILE THE MILITARY HAD DIFFERENT TRADITIONS AND PROFESSIONAL TRAINING, THE LEADERSHIP HAD THE SAME BASIC GOALS. ABOVE ALL, THEY WERE PERSUADED OF THE NEED FOR CONTINUITY AND WOULD ACCEPT EVEN A MEDIOCRE POLICY RATHER THAN CHANGE DIRECTIONS.

8. THE SQUEEZE OF INDUSTRY

KLEIN DISCUSSED THE GOA STRATEGY TO FORCE ARGENTINE INDUSTRY TO BECOME ORIENTED TOWARD THE WORLD MARKET. THE GOA HAS ALREADY REDUCED IMPORT DUTIES TO LIMIT THE AMOUNT OF PRICE INCREASES INDUSTRY CAN PASS ON TO THE CONSUMER WITHOUT ENCOUNTERING FOREIGN COMPETITION. IN TIME, MORE AND MORE PROTECTION WILL BE REMOVED AND INDUSTRY WILL BE GIVEN INCENTIVES TO TURN TO EXPORTS. WHEN ASKED ABOUT POLITICAL VIABILITY OF SUCH A POLICY, KLEIN AGREED THAT POLITICAL PRESSURES FROM THE INDUSTRIAL SECTOR WOULD INCREASE BUT THE GOA HOPED TO CONTROL THEM BY REMOVING

PROTECTIONIST PRESSURES GRADUALLY. THE PARTICULAR PROBLEM OF THE AUTOMOTIVE INDUSTRY, IN WHICH THERE ARE TOO MANY AUTOMOBILE FACTORIES (10) FOR THE SIZE OF THE COUNTRY AND SMALL AUTO PARTS SUPPLIERS, IS CURRENTLY BEING STUDIED. KLEIN ALSO ADMITTED THAT, IF ONE LOOKED ONLY AT THE HISTORY OF ARGENTINA, THE CHANCES OF ARGENTINA BEING ABLE TO RESIST THESE POLITICAL PRESSURES WOULD NOT APPEAR GOOD.

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9. GDP

KLEIN SAID THAT ARGENTINA'S GDP IN 1976 WAS EXPECTED TO BE 3 PERCENT BELOW THAT OF 1975 AND THAT GDP IN THE FOURTH QUARTER HAD GROWN 2 PERCENT. HE ADMITTED, HOWEVER, THAT THE UPTURN IN THE FOURTH QUARTER WAS SOMEWHAT MISLEADING BECAUSE OF THE COMPARISON WITH THE FOURTH QUARTER IN 1975, WHICH WAS PARTICULARLY BAD. THE GOA EXPECTS A 5 PERCENT GROWTH IN GDP IN 1977, WHICH WOULD BRING THE ECONOMIC LEVEL BACK ROUGHLY TO THE LEVEL OF 1974.

10. INFLATION IN 1977

KLEIN SAID THAT INFLATION IN 1977 WOULD BE LOWER THAN THE 100-110 PERCENT PROJECTED BY PRIVATE SOURCES, PRIMARILY BECAUSE OF ADROIT HANDLING OF THE MONEY SUPPLY BY THE CENTRAL BANK AND GREATER EFFORT TO REDUCE THE BUDGET DEFICIT.

11. COMMENT: AS IS UNDERSTANDABLE, KLEIN EXPRESSES CONSIDERABLE CONFIDENCE IN THE GOA'S ABILITY TO CONTROL PRESSURES AND OVERCOME CURRENT PROBLEMS. IN OUR OPINION, THE GOA WILL HAVE MAJOR DIFFICULTY IN REDUCING THE BUDGET DEFICIT IN 1977 TO LEVELS ACCEPTABLE TO THE IMF AND, IF THE WAGE INCREASES RECOMMENDED BY KLEIN MATERIALIZE, INFLATION IN 1977 WILL NOT BE BELOW 100-110 PERCENT LEVEL FORECAST BY PRIVATE SOURCES.

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